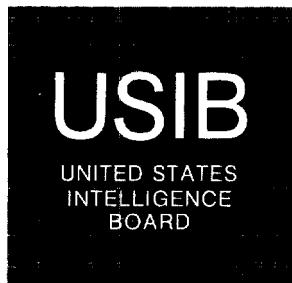


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State Dept. review completed

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ITALY

The consultations that have followed the submission of Prime Minister Rumor's resignation have produced no compromise on the economic policy differences that brought down the Italian government.

The Socialists continue to oppose the credit restraints that the Christian Democrats feel are necessary to stabilize the faltering economy. For their part, the labor unions have made it clear that they will press their economic demands on any new government, although they have indicated they would support a program that would equitably distribute austerity and avoid unemployment.

President Leone has been consulting with political leaders to find a solution. His consultations end today, but there has not been the slightest sign so far of a break in the deadlock or of candidates pressing forward to patch together a new government.

Well-placed sources of the US embassy report that Leone is considering submitting the issues that divide the government to parliament for an open debate and a vote. Leone may float this idea in order to pressure the Socialists--who would not want to bear the full onus of the breakup of the center-left coalition--to make concessions.

The Socialists, however, are not likely to yield. They have been exuding confidence over the Christian Democrats' defeat in the recent referendum on divorce. The Socialists interpreted this result as a sign of a basic shift in Italian voter attitudes in favor of more rapid social change. If, as expected, the regional election in Sardinia next week results in Christian Democratic losses and Socialist gains, the Socialists will probably become even more intransigent.

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FRANCE

The French government yesterday adopted an austerity program designed to slow inflation, restore the balance of payments, expand exports, and finance new social welfare measures.

In a conversation with the US ambassador, President Giscard characterized the program as "harsh." He said he hoped to control inflation--expected to be about 15 percent in 1974--within 18 months.

The program, some of which requires parliamentary approval, includes:

- a reduction of oil consumption by rationing heating supplies, which account for 40 percent of French energy consumption;
- an 18-percent increase in corporate taxes for 1973;
- a special tax on companies that would have paid no tax for 1973;
- an income tax surcharge of up to 15 percent for individuals in the higher brackets, to be partially reimbursed next year;
- a one-time 10-percent tax on real estate profits for 1974;
- a tax designed to limit corporate capital gains derived from inflation.

These tax measures would increase total tax collection for the year by 4 to 5 percent. Other items may include increased prices for gasoline and other fuels, as well as additional measures designed to restrict credit.

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Some of the funds derived from the austerity program will be used to finance the social welfare measures that Giscard promised during his campaign. Significant progress in that area is necessary by fall if he is to maintain labor peace and appease the left.

The government will announce its social program after the cabinet meeting next Wednesday. Public reaction will then indicate whether the people believe the social measures promised by the government are worth the inconveniences of its economy program.

WEST GERMANY

Dissatisfaction in the West German Defense Ministry with the European multirole combat aircraft reportedly now extends to Defense Minister Leber. According to a recent press report, Leber is studying ways to disengage the Federal Republic from the project without creating severe frictions with its partners on the project--the UK and Italy.

Rising costs of the aircraft plus its recent failure to meet the schedule for its initial flight may well have convinced Leber that the project should be canceled.

None of the participating countries heretofore has been willing to risk the political damage to nascent European defense cooperation by withdrawing from the project. Chancellor Schmidt's views on the project are not known, but he has recently spoken of the need to foster European production of weapons systems.

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ARGENTINA

President Peron, after earlier threatening to resign, announced late yesterday that a ten-hour solidarity strike called by Peronist labor and youth organizations had given him the backing he needed to stay on. In a highly emotional address to the nation, the President had said he would quit if massive support was not forthcoming.

Peron is disturbed by recent economic setbacks, which he attributes to sabotage and sectarianism within the Peronist movement. He promised to punish dissidents.

Peron's pique appears to have been precipitated by violations of the Social Pact--an agreement dating from May 1973 between Peronist labor, business, and political leaders to hold down prices and wages in an effort to halt inflation. The pact has come under increasing strain in recent months, however, and a general wage increase and price adjustments have been made ahead of schedule. The adjustments in turn have created demands for further wage increases.

Labor discipline within the Peronist movement has been deteriorating rapidly during the past few weeks. Wildcat strikers on several occasions ignored appeals from their leaders to return to work.

Peron, in moments of frustration over the splits and political fighting within his movement, has previously intimated that he might resign. The fact that Peronist supporters were ordered into the streets right after his dramatic plea, followed by an equally dramatic announcement that he would remain, suggests careful orchestration that could serve as a prelude to new austerity measures. The resignation of the cabinet, as reported in press dispatches, may have been demanded by Peron as a means of facilitating ministerial changes he has been contemplating.

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CHINA-JAPAN

Sino-Japanese negotiations for a new fisheries agreement covering the Yellow and East China seas are deadlocked, according to a Japanese official. The major issue appears to be Chinese insistence on a 200-mile coastal fishing limit.

Details of the Chinese claim are not yet clear, but [redacted] the Chinese position on this and other matters, such as catch limitations and denial of access to PRC "military zones," is very hard. Japanese negotiators have predicted that there will be no agreement on the fisheries problem before June 22, when the current, unofficial pact expires.

Although Peking has voiced support for the 200-mile economic zone concept when it has been broached by other countries, it had in the past privately stated that the principle would not be applied to its own coastal waters. During the negotiations with the Japanese, Peking is keeping in mind issues that will probably arise at the Law of the Sea conference, which opens later this month in Venezuela.

As self-proclaimed leader of the Third World countries, most of whom support the 200-mile economic zone concept, Peking cannot afford to abandon the principle in its own bilateral negotiations with another country. As a result, the Chinese may attempt to stall in their talks with the Japanese, at least until after the Law of the Sea conference. [redacted]

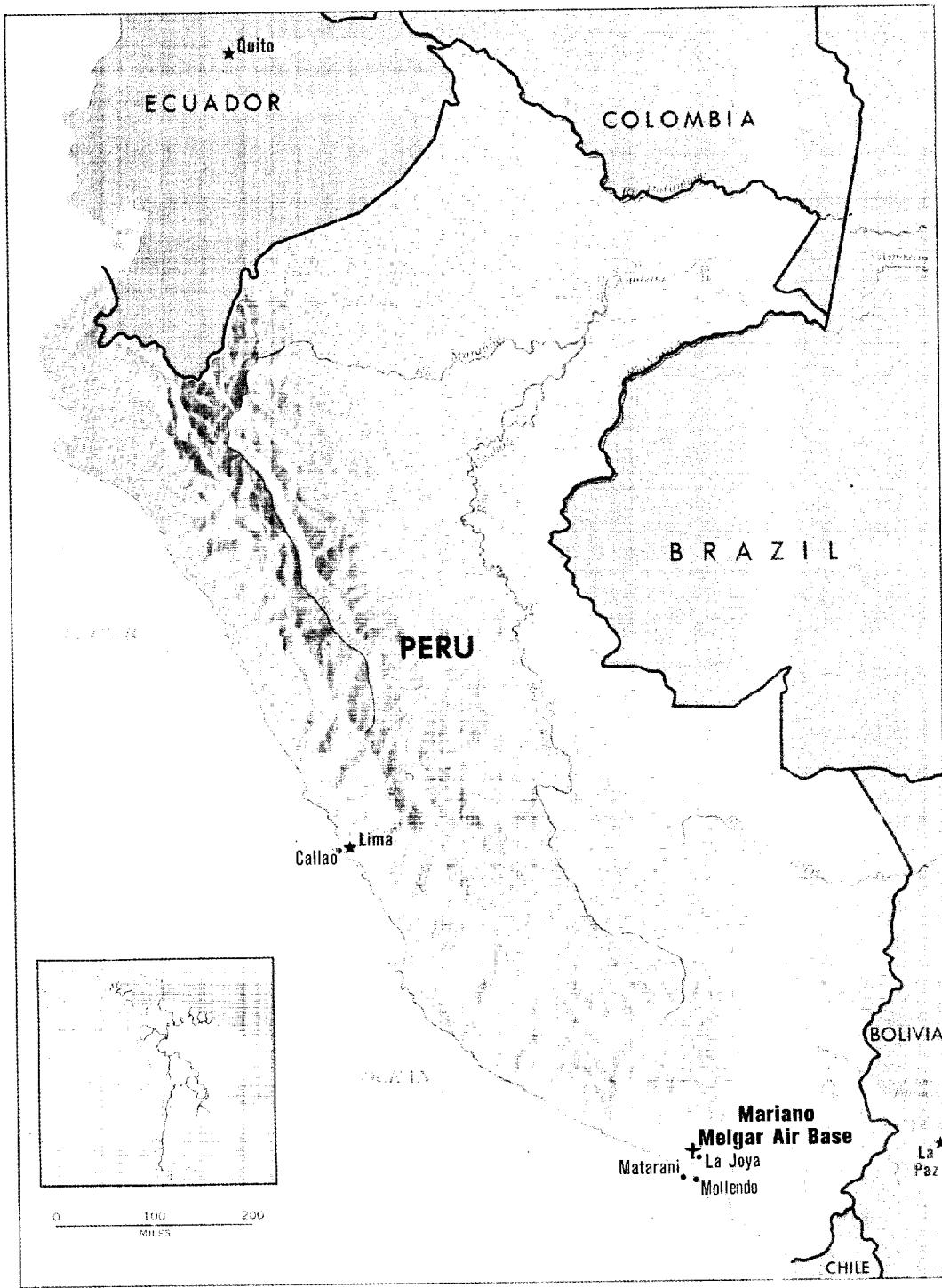
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PERU

Plans to modernize the military continue at a steady pace, reflecting the Velasco government's concern over a perceived threat from Chile. Long-standing Peruvian distrust of Chile has intensified since the overthrow of President Allende.

Chilean leaders likewise are distrustful of Peruvian motives, which they believe may be designed to recover territory lost in the War of the Pacific almost 100 years ago.

Peruvian authorities are particularly sensitive to what they view as Chilean efforts to offset Peru's arms lead. Peruvian military leaders have a deep sense of inferiority vis-a-vis Chile and believe they must maintain a superior force as a deterrent.

To this end, recently acquired air force fighters and army armaments, including Soviet T-55 medium tanks, are being readied for operational status. Additional purchases and improvements appear imminent.

The army is using navy ships and land convoys to transport Soviet tanks and other arms and materiel from Callao to the southern port of Matarani near a new army installation at La Joya. Transshipment of the tanks would be consistent with plans for improving military capabilities in the south.

The eight Mirage V fighters which the air force purchased from France last year have apparently arrived in Lima and will eventually be permanently stationed at Mariano Melgar Air Base, the new fighter group installation at La Joya. Israel has provided a four-man technical team to prepare the aircraft for operational use and may establish a more permanent mission to upgrade Peruvian maintenance capabilities.

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The navy also appears to be developing major military installations in the La Joya area, which may eventually become a joint military complex. Mirages and Canberras have already been using the airfield at Mariano Melgar temporarily as other base facilities near completion.

Development of this complex around La Joya has been planned for several years, because the area is well suited for air and ground training. Since the complex is only some 140 nautical miles from the Chilean border, it would be a valuable staging area and operational base in the event of hostilities with Chile.

The Chilean military will doubtless become aware of Peru's movement of tanks south, heightening their concern over Peruvian intentions. This will serve to reinforce the suspicions of those military leaders who believe the Peruvians themselves are planning an attack.

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THAILAND

The Thai labor movement, throwing its support behind striking textile workers, is threatening to launch a general strike if the government does not accept demands for changes in the labor law. The Sanya government has indicated that it is sympathetic to some of the workers' demands, the most important of which is an increase in the minimum wage. It is likely that government acceptance of this demand would largely defuse the protest, now in its fifth day.

There is a danger, however, that if the government does not move quickly, radical labor and student elements will succeed in escalating the workers' demands beyond the point the government is willing to go. Under such circumstances, the government would face an unpalatable choice between resorting to strong-arm measures against the demonstrators or suffering a further loss of control to the radicals--a situation that would antagonize the military. While the military are reluctant to intervene in the political process, their lack of support could bring Prime Minister Sanya to the point of again offering to resign.

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FOR THE RECORD



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Portuguese Guinea: Cease-fire talks between Lisbon and the Portuguese Guinea insurgents are scheduled to re-open today in Algiers. The first round of talks, held in London, was adjourned on May 31 to give the two sides time to study each other's bargaining position. The insurgents are demanding immediate independence for the territory as the "Republic of Guinea-Bissau," which they proclaimed last fall. While recognizing the possibility of independence, Lisbon is insisting on a popular referendum that will allow the inhabitants of Portuguese Guinea to determine the territory's political future. The insurgents had requested that the talks be moved to Algiers. The Algerian government is a strong backer of the insurgents and is encouraging them to hold out for recognition before agreeing to Lisbon's overriding desire to work out a cease-fire.

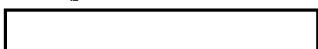
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Cambodia: Prime Minister Long Boret resigned this morning, and President Lon Nol immediately appointed him to form a new government. These moves, under discussion for several days, are aimed at easing political quarreling in Phnom Penh. Boret's new cabinet will probably be enlarged to bring in more officials acceptable to all factions. The new government, likely to be formed in a few days, will also include many holdovers, some with different portfolios.

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